



U. S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

March 20, 1998

MEMORANDUM FOR **M/MPI**, Frank J. Young

FROM: IG/A/PA, David M. Conner

SUBJECT: Worldwide Audit of Selected **USAID** Missions' Role in Obtaining Audits of Their Contracts, Grants, and Cooperative Agreements (Audit Report No. 9-000-98-002-F)

This is our final report summarizing the findings of a worldwide audit by the Office of the Inspector General (OIG) regarding audit coverage efforts on contracts, grants, and cooperative agreements for selected missions. In preparing this report, we considered your comments to our January 15, 1998 draft report and have included these comments as Appendix II. The report contains one recommendation related to cash transfer and non-project sector assistance agreements for which a management decision has been reached. A list of the audit titles and report numbers for the 14 missions included in the review can be found at Appendix IV.

Please provide us information within 30 days on any actions planned or taken to implement the recommendation. I appreciate the cooperation and courtesies extended to the OIG staff during this worldwide audit.

Background

Financial audits of contracts and grants are a primary basis for the effective management and control of the United States Agency for International Development's (**USAID's**) program expenditures. These audits are designed to provide Agency management reasonable assurance that transactions are properly recorded and accounted for; laws and regulations, and the provisions of contract or grant agreements are complied with; and funds, property and other assets are safeguarded against unauthorized use or disposition.

Audits of USAID grant recipients have been required to better ensure accountability of USAID funds. To further improve audit coverage of its assistance activities in developing countries, USAID, in April 1992, reemphasized its responsibility for obtaining audits from its contractors and grantees. Also, in May 1996, USAID consolidated its policies and procedures for financial audits, previously found in several of USAID's Handbooks and directives, into Chapter 591 of the Automated Directives System (ADS). This ADS chapter continued past policy of holding field missions responsible for obtaining required audits from non-U.S. recipients. Responsibility for U.S. recipients remained with the Bureau of Management's Office of Procurement (M/OP) in USAID/Washington.

Chapter 591 (issued May 13, 1996) outlines policies and procedures that apply to financial audits of USAID contractors, grantees, and host government recipients.' The audit requirements and USAID management's role in making sure that the audits are actually performed are summarized below:

- ***U.S. non-profit organizations*** receiving \$25,000 or more in USAID funds in any one year (under grants, cooperative agreements, or contracts) shall have periodic audits performed in accordance with Office of Management and Budget Circular A-133.* These audits will normally be performed annually, but must be performed no less frequently than every two years. The Office of Procurement in USAID/Washington is responsible for making sure that USAID funds provided to these organizations are audited.

U.S. for-profit organizations receiving USAID funds under direct contracts, grants, or cooperative agreements (or cost-reimbursable host country contracts or subcontracts over \$250,000) will have annual audits performed. The Office of Procurement in USAID/Washington is responsible for making sure that USAID funds provided to these organizations are audited.

Foreign for-profit and non-profit organizations receiving \$100,000 or more in USAID funds in a year will have an annual audit performed. USAID overseas missions or a cognizant bureau in USAID/Washington, dependent on who provides the funds, are responsible for making sure that these audits are done.

¹ At the time of audit, a USAID General Notice dated September 26, 1997 (retroactive to January 1, 1997) was issued to supersede or clarify parts of ADS Chapter 591. Among others, one substantive change was to increase audit threshold amounts for non-U.S. organizations who expend \$300,000 or more per year in USAID awards.

² During the time of audit, OMB Circular A-133 was revised. One of the more significant revisions was that the threshold for when an entity is required to have an audit was raised from \$25,000 to \$300,000.

- **Foreign government agencies** receiving **\$25,000** or more in **USAID** funds during a year will have an annual audit performed by a non-Federal auditor or by the foreign host government's Supreme Audit Institution. **USAID** overseas missions are responsible for making sure that these audits are done.
- **International organizations** receiving **USAID** funds may have audit requirements dependent on the terms of the contract or grant agreement provisions.

Our office has issued two reports in this area. In March 1995, our Status Report on **USAID's** Implementation of the Audit Management and Resolution Program (AMRP) (Report No. 03-000-95-009) concluded that **USAID's** overseas missions had made progress towards implementing AMRP and obtaining the required audit coverage. In December 1995, our Audit of Selected **USAID** Central and Regional Bureaus' Management Requirements to Achieve Accountability for **USAID** Funds with non-U.S. Grantees (Report No. 9-000-96-002) concluded that U&AID/Washington's central and regional bureaus needed to improve the monitoring and control of audits and periodically follow-up to ensure such controls are providing the intended coverage.³ This audit is a follow-up review of the **USAID** overseas missions efforts to improve accountability through audits.

Audit Objective

The Office of Audit's Division of Performance Audits in Washington, D.C. and regional offices in Bangkok, Cairo, Dakar, Pretoria, and San Salvador performed audits at 14 **USAID** missions to answer the following audit question: Have selected **USAID** missions carried out their role in obtaining audits of their contracts, grants, and cooperative agreements?

Appendix I contains a discussion of the scope and methodology for the audits.

Summary of Audit Findings

Have selected USAID missions carried out their role in obtaining audits of their contracts, grants, and cooperative agreements?

Eleven of the 14 **USAID** missions, selected for review on a judgmental basis, generally carried out their role in obtaining audits of their contracts, grants, and cooperative agreements, as

³ At the time of audit, **USAID/Washington** bureaus were responsible for the **AMRP** for grants made by the bureaus to non-U.S. entities. As a result of the audit report, the Agency decided to assign the responsibility to **M/OP**.

required by the Automated Directives System (ADS) Chapter 591. In addition, we found that all missions had taken positive actions to implement an effective audit program.

For example, they have:

- established a management control review committee to address management control issues including audit, .
- issued a mission order and other guidance to its staff on audit policies and procedures,
- designated an audit management officer in the controller's office to manage the audit program,
- prepared an audit inventory (database) listing grants and contracts that may be subject to audit requirements, and
- for the contracts and grants we examined, generally included appropriate audit provisions in the agreements.

However, at ten missions, a significant number of required audits were found not to have been completed.⁴ For example, required audits in **USAID/Egypt** were not done because local public accounting firms did not have sufficient capacity to perform more audits. In **USAID/Jordan** the audit inventory did not include enough information on the audits required.

In addition, the audits disclosed that large amounts of funds disbursed by the missions are outside of current Agency guidelines for audit requirements. While most of the exclusions to Agency guidelines appeared reasonable, we believe that certain **USAID** assistance (for example, cash transfers and other forms of non-project assistance) require appropriate audit.

Most Required Recipient Audits Were Performed

ADS Chapter 59 1 requires that foreign for-profit and non-profit organizations receiving \$100,000 or more in a year, under direct **USAID** contracts or grant agreements, shall have periodic audits conducted in accordance with U.S. Government Auditing Standards. Also, foreign host government entities (for example, government ministries) receiving \$25,000 or more in a year, under direct **USAID** grants, are to have periodic audits conducted in accordance with applicable auditing standards.

⁴ The determination of significant is based on a **five** percent error rate as our materiality threshold for reporting non-compliance with **USAID** procedures.

As of October 31, 1996, at the missions selected for audit, 709 audits covering about \$380 million in disbursements to non-U.S. recipients should have been performed. As shown in the following table, 517 of these audits covering \$302.2 million were performed. (See Appendix III Page 1 for further information.)

Table I

	<i>Required</i>	<i>Actually Performed</i>	<i>Required But Not Performed</i>
Number of audits:	709	517	192
Disbursements covered: ⁵	\$380.4 million	\$302.2 million	\$78.3 million

Notwithstanding our earlier comment about a significant number of required audits previously not being completed at certain missions, we found that 10 of the 14 missions reviewed are now taking positive actions to ensure that required audits are performed. For example, we found that nine of the ten required audits for USAID/Zimbabwe's non-U.S. recipient organizations had been performed and that the one remaining audit was not performed because the Mission chose to do a financial review of all costs incurred under the grant in lieu of an audit. Similarly, at USAID/Bangladesh we found that 19 of the 20 required audits had been performed. In the one instance where an audit was not performed the recipient underwent a transition from a USAID sub-activity to a direct grantee.

On the other hand, while most required audits were being performed, there were audit coverage lapses at three missions where improvements were still underway to ensure that all audit requirements for recipients are met. These three missions accounted for 137 out of 192 (about 71 percent) of the audits required but not performed. For example:

- **USAID/Egypt** - USAID/Egypt officials believed that local public accounting firms did not have sufficient capacity to perform all of the required audits. Therefore, 96 of 148 (about 65 percent) required audits were not performed. In August 1994, the Office of the Regional Inspector General for Audit in Cairo agreed with this assessment. Therefore, instead of annual audits as required by USAID policies and procedures, the mission planned audits at longer intervals. Despite these plans, however, USAID/Egypt's fiscal year 1997 audit plan, which included 56 planned audits, recognized that audits should generally be performed annually. If USAID/Egypt is successful in accomplishing these audits, they will cover \$40 million of the almost \$47 million for which audits were required but not performed (the 56 planned audits

⁵ Amounts may not add due to rounding.

represent a 124 percent increase over the 25 audits actually completed in fiscal year 1996). Therefore, substantive corrective action is in process in USAID/Egypt.

- **USAID/Jordan** - 11 of 16 (about 69 percent) required audits covering disbursements of \$1.3 million-; were not performed. Four of these audits, related, to grants which ended several years ago ‘and since USAID/Jordan is no longer assisting these recipients, we believe it impractical, to perform them at this time.’ This gap in audit coverage occurred primarily because USAID/Jordan’s audit inventory did not **include** sufficient information on audits required. For example, the audit inventory only included commitments over \$100,000 rather than all commitments, and did not include actual disbursements to each grantee and contractor.⁶ Also, while the audit inventory indicated when audits were required for most grantees and contractors, it did not indicate when audits were required for host country contractors. USAID/Jordan has agreed to take appropriate action.

- **USAID/Mali** - 30 of 45 (about 67 percent) of the required audits were not completed. As a result, the Mission was not able to ensure the accountability of \$10.5 million that it provided to non-U. S. organizations. USAID/Mali officials cited the lack of capacity on the part of audit firms as one reason for not performing the required audits. However, we also found that the Mission did not: 1) have operational guidance to assist its staff in performing their audit management responsibilities; 2) maintain an accurate audit inventory database; 3) assign the task of maintaining the Mission’s audit inventory data base to an employee; 4) include new audit responsibilities (as a result of re-engineering) in employees’ work objectives; and, 5) retrain staff in their new roles. OIG recommendations to the Mission regarding these issues have been agreed to or are being considered.

Audit Requirements Needed for Cash Transfers and Other Assistance

The audit disclosed that large amounts of funds disbursed by the selected missions are outside of current Agency guidelines for audit requirements. For example, as shown in table II below, during the period from January 1, 1993 through September 30, 1995, USAID missions at **14 locations disbursed about \$4.5 billion.**⁷

⁶ Commitments represent a firm pledge or promise to pay upon fulfillment of the terms of an agreement. Commitments may be in the form of a contract, grant, project implementation letter, or other document.

⁷ This figure includes disbursements under all types of agreements: for example, contracts, grants, cooperative agreements, personal services contracts, bank letters of commitment, travel authorizations, agreements with other U.S. government agencies, etc.

Table II

Missions' Disbursements to Various Organizations	(thousands)
U.S.' entities (USAID/Washington responsibility)	\$2,802,200
Non-U.S. entities, (USAID missions' responsibility)	1,605,000
International entities (dependent on agreement terms)	<u>74,900</u>
Total	<u><u>\$4,482,1</u></u>

As shown in the above table and as previously discussed in this audit report, audits were required for only about \$380 million of the more than \$1.6 billion in mission disbursements to non-U.S. entities from January 1, 1993 through September 30, 1995. Table III below shows some of the categories of disbursements which were excluded from audit coverage.

Table III

Categories of Disbursements	(thousands)
Cash transfer (policy reform activities)	\$ 751,932
Fixed price contracts, purchase orders, travel, and training	223,868
Personal services contracts and other payroll-related costs	41,373
Construction contracts	56,637
Disbursements below the dollar thresholds established by USAID	16,340
Miscellaneous	80,994
Could not determine-scope impairment	<u>5,671</u>
Total	<u><u>\$1,176,815</u></u>

In our opinion, disbursements for categories of procurement/assistance, such as fixed price contracts and personal service contracts, need not have a requirement for independent audit. However, we believe that cash transfers and other forms of non-project assistance should require an audit to ensure proper accountability of funds.

The problem appears to result from ADS Chapter 591 not including definite requirements for audit for cash transfers and other forms of non-project assistance. Whereas a State Department cable (194322) issued on June 15, 1990 held missions responsible for obtaining audit coverage related to Economic Support Fund cash transfers and non-project sector assistance, the formulation of audit requirements into ADS Chapter 591 in May 1996 made no mention of this requirement nor did it identify why such was excluded. We were unable to obtain an explanation as to the reason for the omission of this audit requirement.

In our opinion, the nature of cash transfers and other forms of non-project assistance lend themselves to financial audits to ensure that the funds have been disbursed according to the assistance document and have been accounted for. An audit requirement for these funds makes sense. We are therefore making the following recommendation:

Recommendation No. 1: We recommend that the Office of Management Planning and Innovation issue a written policy to require audits of USAID cash transfer and non-project sector assistance agreements.

Management Comments and Our Evaluation

In responding to the draft report, the Office of Management Planning and Innovation (M/MPI) generally agreed with the report recommendation. M/MPI indicated that additional guidance, in the form of a “general notice”, would be provided to all operating units to ensure that all cash transfer and non-project sector assistance agreements are included in their audit inventory and subjected to audit coverage when required.

M/MPI also stated that given the nature of these agreements it may not be cost effective to require an annual audit by an independent CPA firm. M/MPI indicated that cash transfer and non-project sector assistance agreements should be included in an audit inventory and considered for a financial audit or other type of review during the annual financial audit planning process. According to M/MPI this requirement will be clarified when ADS 591 is reissued.

We will refrain from opining on M/MPI’s proposal for alternative audit procedures, until M/MPI has provided specific written information on the circumstances and procedural guidance for exceptions to a financial audit when a financial audit does not appear to be cost effective.

SCOPE AND METHODOLOGY

Scope

The Office of Inspector General (OIG) conducted a worldwide audit of USAID's field missions audit coverage activities. We conducted our audit in accordance with generally accepted government auditing standards. Fieldwork for the audits took place from July 31, 1996 through December 9, 1997. The audit scope was based on a judgmental selection of missions and covered whether missions (1) published guidance and established direction over their financial audit program, (2) included appropriate audit clauses and budgets in grants and cooperative agreements with overseas entities, (3) established an accurate audit inventory, (4) completed audits as frequently as required, and (5) tracked and resolved audit issues for recipient-contracted audits. The audit examined missions' role in obtaining audit coverage of about \$380 million disbursed to non-U.S. entities from January 1, 1993 through September 30, 1995.

The audits considered recipient financial audits which had been completed as of October 31, 1996. The audit included an assessment of missions' internal controls over the financial audit process and the foreign recipient-contracted audit program. The audit did not cover audit requirements of local currencies generated under the commodity import programs, sector assistance or Economic Support Fund cash transfer programs. We limited our conclusions to the items actually tested: that is, we have not attempted to project the results of tests performed to the accuracy of the data at missions we did not test.

Methodology

Our audit objective was to determine if missions carried out their role in obtaining audits of contracts, grants, and cooperative agreements. In answering this objective, we interviewed officials at missions to obtain an understanding of their audit management program and reviewed applicable Agency guidance and procedures. We then examined documentation of missions' audit management program, including the audit inventory database, audit recommendation tracking system, financial audit reports, related correspondence and project files. We also assessed missions' internal controls over the financial audit process and performed the following audit procedures:

- reviewed missions's local operational guidance to assess the design of audit management procedures and responsibilities;
- verified the accuracy and completeness of missions's audit inventory database by tracing selected data to source documents, such as agreements and accounting records;
- tested a judgmentally selected sample of contracts, grants, and cooperative agreements to determine whether appropriate audit clauses and funding for audits were included in the agreements;
- reviewed audit reports and related correspondence to determine whether audits were performed in accordance with standards, guidelines, timeliness and frequency requirements;
- examined missions's audit recommendation tracking system to determine whether adequate procedures were in place to ensure that audit recommendations were effectively monitored and implemented;
- reviewed the Mission Accounting Control System (MACS) disbursement reports for the period January 1, 1993 through September 30, 1995 to identify disbursements made to U. S., non-U. S. and international organizations;
- identified the number of **non-U.S.** organizations and total **USAID** funding levels for those organizations receiving sufficient funds to require audit during the period January 1, 1993 through September 30, 1995 as well as the number of audit reports due as of October 31, 1996; and
- verified the accuracy of the amount of **USAID** disbursements audited for a judgmentally selected sample of audit reports.

In carrying out these audit procedures, we established a five percent error rate as our materiality threshold for reporting exceptions and non-compliance with **USAID** procedures. Also, for purposes of this audit we had to interpret Agency guidance and mission implementation of the guidance, which requires audits of foreign government recipients receiving \$25,000 or more and foreign private for-profit and non-profit recipients that receive \$100,000 or more in a year, as the recipient's **fiscal** year or the calendar year.



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

February 17, 1998

MEMORANDUM

TO: David Conner, IG/A/PA

FROM: Frank Young, M/MPI- *fyg*

SUBJECT: Draft Report on the Worldwide Audit of Selected **USAID Missions' Role in Obtaining** Audits of Their Contracts, Grants, and Cooperative Agreements.

You requested comments on the draft report summarizing findings of the worldwide audit on audit coverage of **contracts, grants,** and cooperative **agreement8** for selected missions. The report contains one recommendation that the Office of Management Planning and Innovation **revise** ADS Chapter 591 to include an audit requirement for **USAID** assistance in the form of cash transfer8 and non-project sector assistance.

ADS Chapter 591 currently applies to all grants, cooperative agreements and contract8 issued by the Agency. Since cash transfer8 and non-project assistance are in the form of a grant or cooperative agreement, we do not believe it **is necessary** to amend ADS 591 to include an audit requirement as one already exists. However, **based on the results of the audit, we do believe that additional** guidance should be provided to all operating units to ensure that cash transfer and non-project assistance **agreements** are included in their audit inventory and considered for **a financial audit or other appropriate review.** Given the nature of these agreements, it may not be **COST** effective to require an annual audit by an independent CPA firm. However, each agreement should be subject to an annual review by the operating unit to **determine the action necessary** to properly ensure accountability for the disbursed funds. We will issue a general notice to the operating units to remind them that all grants, cooperative agreements and contracts, including those for cash transfers and non-project assistance, should be included in their audit inventory and considered for an audit or another type of review during their annual financial audit planning process. We will also clarify this requirement in ADS 591 when it is reissued.

Based on the above planned action, the Agency requests that Recommendation No. 1 be **considered** to have had a management **decision upon issuance of the final report.** **We will consider** Recommendation No. 1 to have had final action when the general **notice is issued.**

We appreciate the **IG's** continuing efforts to support the **Agency's** commitment to strong **systems** of internal control and accountability for taxpayers **funds.**

CC: Jan Miller, **GC/LP**
Tony **Cully, M/FM/CONT**
Terry Barker, **PPC/PC**

Table I: Summary Of USAID Missions Financial Audit Data (in millions)⁸

	Required	Performed	Not Performed
Disbursements/ No. of Audits			
Egypt	\$84.4/148	\$37.71 52	\$46.71 96
Jordan	3.3/ 16	2.1/ 05	1.3/ 11
Zimbabwe⁹	2.7/ 10	2.61 09	.1/ 01
South Africa	48.61215	41.21179	7.41 36
Bolivia	70.11 68	70.11 68	0/ 00
Guatemala	31.61 66	31.5/ 65	.1/ 01
Mali	16.21 45	5.7/ 15	10.51 30
Guinea	0/ 00	0/ 00	0/ 00
Bangladesh	14.11 20	12.91 19	1.21 01
Philippines	54.3/ 58	51.81 48	2.5/ 10
India	33.5/ 25	25.3/ 21	8.2/ 04
Dominican Republic	20.21 33	20.21 33	0/ 00
Senegal	.7/ 03	.5/ 02	.2/ 01
Ghana	<u>.7/ 02</u>	.6/ 01	.1/ 01
Total	\$380.41709	\$302.215 17	\$78.3/192

⁸ Amounts may not add due to rounding.

⁹ Amount was actually \$2.69 million for required audits and \$45,000 for the audit not performed.

Table II: USAID Mission Disbursements To Selected Entities (in thousands)

	U.S. Entities	Non-U.S. Entities	International Entities	Total Disbursed
Egypt	\$1,718,000	\$ 796,000	\$ 5,000	\$2,5 19,000
Jordan	53,000	45,500	300	98,800
Zimbabwe	4,300	7,100	10,000	21,400
South Africa	59,000	102,700	1,500	163,200
Bolivia	141,200	177,000	8,400	326,600
Guatemala	113,200	84,100	20,000	217,300
Mali	20,000	24,000	0	44,000
Guinea	33,000	18,400	0	5 1,400
Bangladesh	96,100	16,000	10,900	123,000
Philippines	445,500	224,600	14,300	684,400
India	29,100	51,100	900	81,100
Dominican Republic	35,300	44,000	2,500	8 1,800
Senegal	36,500	9,000	0	45,500
Ghana	<u>18,000</u>	<u>5,500</u>	<u>1,100</u>	<u>24,600</u>
Total Disbursed	\$2,802,200	\$1,605,000	\$74,900	\$4,482,100

List of the 14 USAID Missions Included in the Review

- 1) **Audit of the USAID/Egypt's Role in Obtaining Audit Coverage of Its Contracts, Grants, and Cooperative Agreements (Report No. 6-263-97-001-P Dated January 31, 1997)**
- 2) **Audit of USAID/Jordan's Role in Obtaining Audits of Its Contracts, Grants, and Cooperative Agreements (Report No. 6-278-97-004-P Dated March 10, 1997)**
- 3) **Audit of USAID/Zimbabwe's Role in Obtaining Audits of its Contracts, Grants, and Cooperative Agreements (Report No. 4-613-97-004-P Dated February 28, 1997)**
- 4) **Audit of USAID/South Africa's Role in Obtaining Audits of its Contracts, Grants, and Cooperative Agreements (Report No. 4-674-97-003-P Dated February 7, 1997)**
- 5) **Audit of USAID/Bolivia's Role in Obtaining Audits of Contracts, Grants, and Cooperative Agreements for Argentina, Bolivia, Brazil, Chile, Paraguay, and Uruguay (Report No. 1-511-98-002-P Dated January 21, 1998)**
- 6) **Audit of USAID/Guatemala's Role in Obtaining Audits of Contracts, Grants, and Cooperative Agreements for Guatemala, Mexico, and the Central American Program (Report No. 1-520-97-003-P Dated September 12, 1997)**
- 7) **Audit of USAID/Mali's Role in Obtaining Audit Coverage of its Contracts, Grants, and Cooperative Agreements (Report No. 7-688-97-006-P Dated June 6, 1997)**
- 8) **Audit of USAID/Guinea's Role in Obtaining Audit Coverage of its Contracts, Grants, and Cooperative Agreements (Report No. 7-675-97-005-P Dated May 29, 1997)**
- 9) **Audit of USAID/Bangladesh's Role in Obtaining Audits of Its Contracts, Grants, and Cooperative Agreements (Report No. 5-388-97-003-P Dated August 19, 1997)**
- 10) **Audit of USAID/Philippines' Role in Obtaining Audits of Its Contracts, Grants and Cooperative Agreements (Report No. 5-492-98-001-F Dated November 28, 1997)**
- 11) **Audit of USAID/India's Role in Obtaining Audits of Its Contracts, Grants and Cooperative Agreements (Report No. 5-386-98-001-P Dated October 10, 1997)**

List of the 14 USAID Missions Included in the Review

- 12) Audit of USAID/Dominican Republic's Role in Obtaining Audits of Contracts, Grants, and Cooperative Agreements for Dominican Republic, Guyana, and the Regional Development Office for the Caribbean (Report No. 1-517-98-001-P Dated December 30, 1997)**
- 13) Audit of USAID/Senegal's Role in Obtaining Audit Coverage of Its Contracts, Grants, and Cooperative Agreements (Report No. 7-685-97-007-P Dated August 22, 1997)**
- 14) Audit of USAID/Ghana's Role in Obtaining Audits of Its Contracts, Grants, and Cooperative Agreements (Report No. 7-641-97-008-P Dated August 27, 1997)**